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EX PARTE OR LATE FILED

April 29, 1997

**EX PARTE**

**BY HAND**

William F. Caton  
Acting Secretary  
Federal Communications Commission  
1919 M Street, N.W.  
Room 222  
Washington, D.C. 20554

RECEIVED  
APR 29 1997

Re: CC Docket No. 96-262 -- In the Matter of Access Charge Reform  
(Notice of Proposed Rulemaking)

Dear Mr. Caton:

On April 29, 1997, on behalf of America Online, Inc. ("AOL") a copy of the attached document was provided to Chairman Hundt; Commissioner Ness; Commissioner Quello; Commissioner Chong; Blair Levin; Thomas Boasberg, John Nakahata; James Casserly; James Coltharp; Daniel Gonzalez; Joseph Farrell; Gregory Rosston; Regina Keeney; Robert Pepper; A. Richard Metzger, Jr.; Kathy Franco; James Schlichting; Jane Jackson; Larry Atlas; Richard Lerner; Douglas Slotten; Richard Welch; Pat Degraha; William Kennard; Mary Beth Murphy; and Laurence Bourne.

Pursuant to Section 1.1206(a)(1) of the Commission's Rules, two copies of this Notice are attached for inclusion in the public record in the above-captioned proceedings.

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William F. Caton

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Should you have any questions regarding this matter, please contact me.

Sincerely,



Donna N. Lampert

Attachments

cc: Chairman Hundt  
Commissioner Ness  
Commissioner Quello  
Commissioner Chong  
Blair Levin  
Thomas Boasberg  
John Nakahata  
James Casserly  
James Coltharp  
Daniel Gonzalez  
Joseph Farrell  
Regina Keeney  
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Gregory Rosston  
A. Richard Metzger, Jr.  
Kathy Franco  
James Schlichting  
Jane Jackson  
Larry Atlas  
Richard Lerner  
Douglas Slotten  
Richard Welch  
Pat Degraha  
William Kennard  
Mary Beth Murphy  
Laurence Bourne

## **THE FCC SHOULD REFORM ACCESS CHARGES TO REFLECT ECONOMIC COSTS AND PROMOTE FAIR COMPETITION**

### **Introduction and Summary**

In order to fulfill the goals of the Telecommunications Act of 1996 ("1996 Act") to promote robust competition, make any subsidies explicit<sup>1/</sup> and promote the continued development of the Internet,<sup>2/</sup> the Commission must reform access charges in a way that closely relates prices to economic costs and ensures that end users, including users of second lines and business customers, do not bear costs that they do not cause. Failure to take such sound action will skew the telecommunications marketplace and undermine fair competition. Indeed, without economic pricing that mirrors the competitive market, there can be no genuine reform.

The presubscribed interexchange carrier charges ("PICC") currently under consideration by the Commission would have a direct and disproportionate negative impact on the Internet industry. First, Internet service providers ("ISPs") do not use the ILECs' networks to make long distance calls and therefore should not be required to pay rates that recover long distance costs, particularly when they will see no companion decrease in long distance charges as other business users will. As the PICC charges are restructured access charges, they should not be recovered from non-access users. Second, many Internet users rely upon second lines for their access, so that new, non-cost-based charges on such users would likely suppress demand with no economic basis or legitimate offsetting benefit to these users. Finally, these uneconomic payments will be made to the ILECs, who are direct competitors in offering Internet services, and thus would unfairly tilt the competitive playing field in the ISP market.

To promote competition and attain the goals of the 1996 Act, America Online, Inc. ("AOL") urges the FCC to reform access charges by adopting an economically rational framework. To this end, AOL endorses the Administration's approach.<sup>3/</sup> The FCC should do the following: (1) restructure rates in the manner costs are incurred; (2) bring rates to forward-looking TSLRIC cost levels; (3) reduce rates by adjusting the price cap productivity factor and by re-initializing rates to allow only "normal" profits; (4) if any new charges are deemed necessary, establish a transition plan with a reasonable cap on any new charges; (5) require that any transition plan establish low charges in the early years when the availability of actual competitive alternatives is the lowest; and finally, (6) refrain from instituting reforms that are predicated upon the outcome of future proceedings.

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<sup>1/</sup> 47 U.S.C. § 254(e).

<sup>2/</sup> Id. at § 230(b).

<sup>3/</sup> See Letter from Larry Irving, Administrator, National Telecommunications Information Administration, filed in FCC CC Docket No. 96-262 (April 24, 1997) ("NTIA Letter").

## Discussion

### **I. Proposals Significantly to Increase Non-Cost-Based Charges to Second Line and Multi-Line Business Users Would Have a Disproportionate Impact on the Internet Industry and Impede Its Growth**

The Commission's current proposal to restructure the bulk of today's access charges into flat charges paid primarily by multi-line business users and second line residential customers, without fundamentally addressing rate level issues, would disproportionately burden the Internet industry, including ISPs and users; skew fair competition in the Internet business; and dampen the continued growth of the Internet.<sup>4/</sup>

#### ***1. Requiring Multi-Line Business Customers Such as ISPs to Bear Non-Cost-Based Charges Imposes an Arbitrary and Discriminatory Burden, Particularly Because They Do Not Want or Use Access Services***

As the FCC restructures access charges and corrects the rate levels, it must ensure that it does not shift costs in a way that arbitrarily burdens certain users, especially when there will be no offsetting benefit. It was for this reason that the FCC tentatively concluded that today's uneconomic access charges should not apply to ISPs and opened a Notice of Inquiry to compile legitimate cost data regarding ILEC network costs related to ISPs.<sup>5/</sup> Consistent with this fundamental tenet, the FCC should not permit the imposition of substantial additional charges upon multi-line business users such as ISPs who neither want nor use "access services," nor make any long distance calls on these lines. Significantly, AOL and other ISPs, have repeatedly underscored that the efficient flow of their data traffic is best accommodated by data-friendly networks, not the circuit-switched network, the costs of which access charges are designed to recover.<sup>6/</sup> Saddling ISPs with these additional costs, which for AOL alone could be well into the tens of millions of dollars annually, would be arbitrary and discriminatory; send precisely the wrong signals about the economic costs of doing business; and, in effect, impose the very uneconomic "access charges" upon the Internet industry that the FCC has repeatedly stated it would not mandate.

Critically, while new flat-rated charges on local phone lines may eventually lead to cost savings on long distance bills for most multi-line business users, such savings will not inure to the benefit of AOL and other ISPs who do not make long distance calls on their business lines. Further, given the exceedingly thin profit margins in the ISP business, it is realistic to expect that

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<sup>4/</sup> See 47 U.S.C. §§ 230(a), (b).

<sup>5/</sup> Notice of Inquiry, *supra*, at ¶ 315.

<sup>6/</sup> See, e.g., Comments of America Online, Inc. in CC Docket No. 96-262 at 3 (Jan. 29, 1997); Comments of the Internet Access Coalition in CC Docket No. 96-262 at 22-23 (Jan. 29, 1997); Comments of America Online, Inc. in CC Docket No. 96-263 at 16 (Apr. 24, 1997).

these new rate increases would likely ultimately be borne by users.<sup>7/</sup> Thus, rather than preserving and promoting the robustness and growth of the Internet, the new charges would create disincentives for the Internet's use and development.<sup>8/</sup>

**2. *Imposing Non-Cost Based Charges on Users of Second Lines Would Likely Suppress Internet Demand***

Today, many users of the Internet have arranged for second telephone lines for their Internet connections.<sup>9/</sup> These lines presently bear the full amount of the Subscriber Line Charge ("SLC") and are priced by state regulatory bodies under relevant state tariffs. Evidence indicates that the ILECs' actual costs for deploying these lines have been below the prices users have been charged, thereby resulting in a windfall to the ILECs who provide them.<sup>10/</sup> Indeed, the ILECs have expended considerable resources promoting the installation of second lines and many have gone so far as to offer several months of free or reduced-rate Internet access (using ILEC-affiliated ISPs) as a further incentive to attract second line customers. Thus, requiring users of second lines to bear an increase in both the SLC, and new, flat-rated, non-cost-based charges, as high as an additional 20 percent per-line, per-month, will send precisely the wrong economic signals about true costs and could suppress, without any genuine or sound economic basis, demand for second lines for the use of the Internet and other data services. Indeed, such a result is directly at odds with the Congressional intent to enhance and expand Internet availability.<sup>11/</sup>

**3. *Requiring that ISPs and their Users Pay Non-Cost-Based Charges to the ILECs Would Unfairly Distort the Competitive Market for Internet Services***

Finally, imposing these additional uneconomic charges on Internet service suppliers and Internet users would skew the Internet services marketplace and unfairly undermine a vigorously competitive industry. Today, every major ILEC has announced its intention to enter the Internet

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<sup>7/</sup> See Comments of America Online, Inc. in CC Docket No. 96-262 at 6-7.

<sup>8/</sup> Moreover, the ILECs would still have no increased incentive to deploy new, data-friendly technologies, and ISPs such as AOL would pay more for inefficient circuit-switched services.

<sup>9/</sup> See Economics and Technology, Inc., "The Effect of Internet Use on the Nation's Telephone Network," Jan. 22, 1997 ("ETI Study") at 25-26 (filed as an attachment to the Comments of the Internet Access Coalition in CC Docket No. 96-262 (Jan. 29, 1997)).

<sup>10/</sup> See ETI Study at 26; Comments of America Online, Inc. in CC Docket No. 96-262 at 14-15 (Jan. 29, 1997).

<sup>11/</sup> Congress has found that Internet services "represent an extraordinary advance in the availability of educational and informational resources to our citizens," that they offer "a forum for a true diversity of political discourse, unique opportunities for cultural development, and myriad avenues for intellectual activity," and thus, the policy of the United States should be to preserve and promote the vibrancy of the Internet. 47 U.S.C. § 230(a) and (b).

services marketplace and most have already been aggressively pursuing this segment of the market.<sup>12/</sup> As stated, many ILECs have been discounting heavily or providing free Internet service as an incentive for ILEC customers to buy second lines, thereby unfairly using their de facto market position in telecommunications provisioning to advance their Internet access business and putting non-ILEC affiliated ISPs at an unfair competitive disadvantage. At the same time, however, the new non-cost based access charges that would be imposed on ISPs would be paid directly to these ILEC competitors. Thus, even though other businesses who may make few or no long distance calls do exist, ISPs would be at a particular disadvantage, as these other businesses do not compete directly with the ILECs. Given the past practices of the ILECs entering competitive businesses, the FCC should not structure a system where the potential for anticompetitive abuse is increased.<sup>13/</sup>

## **II. The FCC Should Only Allow Recovery of Economic Costs**

In reforming access charges, the FCC should be guided by principles of sound economics and eliminate, rather than shift, the “non-cost-based rates” that have historically been part of the access charge scheme.<sup>14/</sup> As the FCC has recognized repeatedly, the pricing regimes it adopts should replicate the conditions of a competitive market,<sup>15/</sup> thereby attaining the benefits of competition – lower prices, innovation and improved quality.<sup>16/</sup> Therefore, the Commission’s reform of access charges must ensure that users pay charges in the same way they cause costs (e.g., flat rates for fixed costs), and that these rates reflect only reasonable, forward-looking

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<sup>12/</sup> See Comments of America Online, Inc. in CC Docket No. 96-262 at 36-37 (Mar. 27, 1997).

<sup>13/</sup> Indeed, it is the very concern about potential anticompetitive conduct that led Congress to set forth significant safeguards as the former Bell Operating Companies seek to provide long distance services. See 47 U.S.C. §§ 271 and 272.

<sup>14/</sup> In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, Notice of Proposed Rulemaking and Third Report and Order, CC Docket Nos. 96-262, 94-1, 91-213, FCC No. 96-488 (rel. Dec. 24, 1996) (“Notice of Proposed Rulemaking”); see also Access Reform Task Force Federal Perspectives on Access Charge Reform: A Staff Analysis (Apr. 30, 1993).

<sup>15/</sup> In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, 11 FCC Rcd 15499 (1996) (“Interconnection Order”) at ¶ 716.

<sup>16/</sup> To the extent that interstate access rates remain inefficient and non-cost-based, competition in all telecommunications markets can be skewed. For example, if access charges are priced incorrectly, interexchange carriers (“IXCs”) who are also competitive local exchange carriers (“CLECs”) will be better off than IXCs who are not, because the former will not be required to pay inefficient charges.

incremental costs. AOL remains fully willing to pay in this way for such costs it causes, and has actively participated in the FCC's Notice of Inquiry designed to address that issue.<sup>17/</sup>

Furthermore, while the FCC may seek to develop a transition scheme to move away from current excessive rates, it should be careful not to create new distortions and inefficiencies that will skew the competitive marketplace. Simply substituting one set of uneconomic charges with another does nothing to meet the goals of the 1996 Act. In addition, the FCC must avoid shifting existing excessive rates to specific classes of users, who do not and will not cause these costs, on the premise that there will be competitive alternatives. While one day viable competition may exist, there remain significant de facto impediments to competition today. Consequently, most users, including the largest customers, do not always have true competitive choice.<sup>18/</sup> Most importantly, the FCC must not act today to raise charges for certain users on the assumption that some future regulatory proceedings or developments will "fix" the system.<sup>19/</sup>

Consistent with these principles, the FCC should recognize that significant portions of today's access charges, including the carrier common line charge ("CCLC") and the transport interconnection charge ("TIC") do not reflect underlying economic costs.<sup>20/</sup> Thus, the FCC should require actions that reduce prices for access services, and eliminate rates that reflect incumbent local telephone company ("ILEC") excess profits; ILEC inefficiencies; jurisdictional misallocations; and other non-cost based "legacy" amounts. The FCC can achieve this through a continuation of actions, including restructuring charges so that they are based on forward-looking

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<sup>17/</sup> In the Matter of Usage of the Public Switched Network by Information Service and Internet Access Providers, Notice of Inquiry, CC Docket No. 96-263, FCC 96-488 (rel. Dec. 24, 1996) ("Notice of Inquiry").

<sup>18/</sup> Significantly, there have been attempts by several ILECs to create disincentives to CLECs to offer competitive service to one class of multi-line business users, Internet Service Providers ("ISPs"), such as by refusals to pay legitimate mutual compensation payments. See, e.g., Comments of USTA in CC Docket No. 96-263 at 20-21 (Mar. 24, 1997); Comments of Pacific Telesis in CC Docket No. 96-263 at 21-24 (Mar. 24, 1997); Letter of NYNEX (stating that such payments will be withheld), Ex Parte filing of America Online, Inc., CC Docket No. 96-263, April 25, 1997.

<sup>19/</sup> If the FCC concludes that additional proceedings are needed, it should defer action here until such other proceedings are completed so that action will be simultaneous.

<sup>20/</sup> In the Matter of Transport Rate Structure and Pricing, Petition for Waiver of the Transport Rules filed by GTE Service Corporation, Report and Order and Further Notice of Proposed Rulemaking, 7 FCC Rcd 7006, 7019 (1992); In the Matter of Federal-State Joint Board on Universal Service, Notice of Proposed Rulemaking and Order Establishing Joint Board, CC Docket No. 96-45, FCC 96-93 (rel. Mar. 8, 1996) at ¶¶ 113-114; Interconnection Order at ¶ 718; Competitive Telecomm. Ass'n v. Fed. Communications Comm'n, 87 F.3d 522, 526-27 (D.C. Cir. 1996).

pricing mechanisms such as TSLRIC, which the FCC has endorsed in its Interconnection Order,<sup>21/</sup> modifying its price cap system to reduce rates, including through X-factor adjustments; eliminating charges that are not the demonstrated costs of providing the services; limiting ILEC investment returns to a “normal” level; and capping the amounts that may be recovered through restructured (flat-rate) charges.

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<sup>21/</sup> See NTIA Letter, supra.